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No. 82-251

In the Supreme Court of the United States

OCTOBER TERM, 1982

ESTATE OF HARRY E. WRIGHT, JR., PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

MEMORANDUM FOR THE UNITED STATES IN OPPOSITION

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The question presented by the petition in this federal income tax case is whether the decision below correctly held that only 50% of petitioner's gross income for 1970-1972 was permanently set aside for a charitable purpose pursuant to the terms of its governing instrument, so as to be deductible under Section 642(c)(2) of the Internal Revenue Code of 1954 (26 U.S.C.).

The pertinent facts may be summarized as follows: The decedent, Harry E. Wright, Jr., died on November 11, 1969, leaving a will that directed that his residuary estate should go to "such charitable, educational, or other worthy recipients of whatever kind or nature as my attorneys and executors shall select." Decedent's sister, Earline Wright Torecellan, who had been disinherited, filed an opposition to the will's probate. On April 28, 1972, however, she reached agreement with the executor of decedent's estate and the charitable trust to which the executor had appointed the

estate's residue to allow a declaratory relief action that would determine the effect of a residuary clause in decedent's will. Shortly thereafter, on August 3, 1972, she died and under these changed circumstances a final settlement agreement was effected providing for decedent's residuary estate to be divided equally between Torecellan's estate and the charitable trust. The Probate Court, to which decedent's will had been offered for probate, approved this agreement and ordered a preliminary partial distribution of $500,000 each to the trust and Torecellan's estate. Subsequently, on November 14, 1973, the Superior Court presiding over the declaratory relief action ruled that the charitable trust was the residuary legatee of decedent's estate. The matter was uncontested and a stipulation and waiver was filed (Pet. App. A-8 to A-11).

Initially, petitioner filed fiduciary income tax returns for the years at issue in which it claimed all of its gross income as a charitable deduction. In 1974, petitioner filed amended returns to take into account the settlement of the will contest. These returns claimed a charitable deduction of only 50% of the gross income because 50% of the underlying residuary estate was to be distributed to the contesting heir's estate, a non-charitable interest. Later in 1974, however, petitioner filed reamended returns seeking to deduct as a charitable deduction all the gross income earned by it for the tax years 1970 through 1972. On audit, the Internal Revenue Service denied the claims and petitioner instituted this refund suit in the United States District Court for the Northern District of California.

On cross-motions for summary judgment, the district court ruled for the United States. It reasoned that 100% of petitioner's gross income earned for the years at issue was not deductible as amounts permanently set aside for a charitable purpose when a will contest was pending during that

period and only 50% of the residuary estate was ultimately distributed, in accordance with the settlement agreement, to a charity (Pet. App. A-20 to A-21). The court of appeals affirmed (Pet. App. A-1 to A-6).[1]

1. The decision below correctly held that the decedent's estate was limited to a charitable deduction equal to 50% of its gross income for the years in question.

Section 642(c)(2) of the Code provides, in pertinent part, that an estate is entitled to deduct any amount of gross income "which pursuant to the terms of the governing instrument is, during the taxable year, permanently set aside for [a qualified charitable purpose] * * *." Petitioner contends that it is entitled to claim a charitable contribution deduction of 100% of the estate's gross income for the taxable years in question notwithstanding the fact that only 50% of the estate's residue (and its gross income) was ultimately distributed, pursuant to the settlement agreement, to the charitable trust. In reliance upon *McClung* v. *Commissioner*, 13 B.T.A. 335 (1928), petitioner argued below (Pet. App. A-13 to A-14) that the tax consequences were controlled by the terms of the will which, in petitioner's view, required that the entire income from the residuary estate be "permanently set aside" for the charitable trust.

The court below, however, chose not to follow *McClung*, which turned on the applicable state law.[2] Instead, the lower

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[1]The opinion of the court of appeals is reported at 677 F. 2d 53 (1981).

[2]Under factual circumstances similar to those in the instant case, the Board of Tax Appeals ruled in *McClung* that the entire income from the decedent's residuary estate for the tax years in question was deductible pursuant to the statutory predecessor of Section 642(c) of the Code. The Board concluded that the will explicitly directed the residue of the estate to be left to a specified tax exempt organization and that, in accordance with the applicable state law, the settlement agreement could not nullify

courts relied upon this Court's subsequent decision in *Lyeth* v. *Hoey*, 305 U.S. 188 (1938). There, the question presented was whether an amount paid to an heir by a decedent's estate in compromise of a will contest was exempt from income tax under Section 22(b)(3) of the Internal Revenue Code of 1939 (26 U.S.C. (1952 ed.)), the statutory predecessor of Section 102 of the 1954 Internal Revenue Code. Both of these provisions exempt from income tax the "value of property acquired by bequest, devise or inheritance." This Court first ruled that in deciding the issue, federal, and not state law should apply since "it was the intention of Congress * * * to provide a uniform rule" with respect to federal tax statutes (305 U.S. at 194). Secondly, while holding that the petitioner there had, pursuant to the compromise agreement, acquired his portion of the property by inheritance for purposes of Section 22(b)(3), this Court concluded that to the extent that distribution of the estate was made in accordance with agreement, "it overrode the will" (305 U.S. at 196).

To be sure, as petitioner notes (Pet. 10-11), *Lyeth* involved a different tax statute from that at issue here. There is, however, no reason to suppose that Congress intended that the question of the amount deductible by an estate under Section 642(c) of the Code should be subject to conflicting interpretations of various state laws. *Weir Foundation* v. *United States*, 362 F. Supp. 928 (S.D.N.Y. 1973), aff'd, 508 F. 2d 894 (2d Cir. 1974).[3] Thus, in accordance with *Lyeth* v. *Hoey*, *supra*, the court of appeals

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the terms of the will (13 B.T.A. at 338). As the court of appeals noted (Pet. App. A-3), the characterization of funds in *McClung* by virtue of state law "depended on the language of the will and not the actual disposition after settlement of the will contest."

[3]Cf. *Burnet* v. *Harmel*, 287 U.S. 103, 110 (1932), holding that "[s]tate law may control only when the federal taxing act, by express language or necessary implication, makes its own operation dependent upon state law." See *United States* v. *Mitchell*, 403 U.S. 190 (1971).

correctly observed (Pet. App. A-4) that "the issue should be governed by federal law" and that "[t]he paramount concern, for federal tax purposes, is with the real distribution of the funds."[4]

Upon application of this analysis to the statutory language of Section 642(c) in the context of the instant case, it is apparent that the final settlement agreement, and not the will, constituted the governing instrument. Pursuant to the probate court order, the actual distribution of the estate's residue (and its gross income) was governed by the settlement agreement. See *Emanuelson* v. *United States*, 159 F. Supp. 34 (Conn. 1958); *Middleton* v. *United States*, 99 F. Supp. 801 (E.D. Pa. 1951). Cf. *Lyeth* v. *Hoey*, *supra*, 305 U.S. at 196. It is equally apparent that the income received by the estate in the taxable years at issue and while the will contest was pending, cannot be said to have been "permanently set aside" for charitable purposes, at least to the extent that the charitable trust did not, under the settlement agreement, receive a vested interest in the residue of the estate. See *Fidelity Trust Co.* v. *United States*, 253 F. 2d 407 (3d Cir. 1958); *Emanuelson* v. *United States*, *supra*; *Genesee Merchants Bank & Trust Co.* v. *United States*, 37 A.F.T.R. 2d 747 (E.D. Mich. 1976). In short, therefore, the statute authorizes a deduction only for the amount of the estate's gross income (*i.e.*, 50%) that was actually received by the charitable trust.

2. *Commissioner* v. *Citizens & Southern National Bank*, 147 F. 2d 977 (5th Cir. 1945), aff'g 3 T.C. 40 (1944), the only appellate decision which petitioner claims (Pet. 8) to

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[4]Cf. *Ahmanson Foundation* v. *United States*, 674 F. 2d 761, 771 (9th Cir. 1981); *In re Sage's Estate*, 122 F. 2d 480, 484 (3d Cir. 1941), cert. denied, 314 U.S. 699 (1942), quoting *Heim* v. *Nee*, 40 F. Supp. 594, 595 (W.D. Mo. 1937) ("[t]he amount to be deducted for * * * charitable gifts must be computed on the basis of what the charities actually received, not on the basis of what is provided in the will.")

conflict with the ruling below, is distinguishable. There, the decedent's will provided that his entire estate was to be distributed to a corporation that would, subject to certain specific bequests, devote the income therefrom exclusively to charitable purposes. The decedent's widow filed suit to contest the will but then agreed to settle her claim for payment of $500,000. While it held that the entire amount of the estate's gross income, less that portion used to pay the above-mentioned bequests, was deductible under the statutory predecessor of Section 642(c), the Tax Court specifically found that the settlement payments to the widow were charged to the estate's corpus accounts (3 T.C. at 52). Accordingly, unlike the instant case, the estate there did not seek to take a charitable deduction for an amount of gross income that was distributed to a non-charitable interest. Moreover, contrary to petitioner's contention (Pet. 9-10), the Tax Court in that case did not state that payment of the $500,000 to the widow in settlement of the will contest was immaterial to its deductibility under the statute. Rather, it merely ruled that such payment was "not material" to whether the testamentary provisions contained in decedent's will, taken as a whole, were charitable in nature (*ibid.*).[5]

It is therefore respectfully submitted that the petition for a writ of certiorari should be denied.

REX E. LEE
Solicitor General

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[5]Finally, petitioner's suggestion (Pet. 12) that the decision below "hamper[s] administration of estates by leaving characterization of their funds in limbo" is belied by the facts of this case. As the court of appeals noted (Pet. App. A-5), petitioner was fully able to take into account changed circumstances by the filing of amended returns, to reflect the terms of the settlement agreement. See *Ahmanson Foundation* v. *United States, supra.*

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